|  |
| --- |
| **MODIFICATION PROPOSAL FORM** |
| **Proposer***(Company)* | **Date of receipt***(assigned by Secretariat)* | **Type of Proposal***(delete as appropriate)* | **Modification Proposal ID***(assigned by Secretariat)* |
| **SEMOpx** | **28 November 2017** | **Provisional** | **Mod\_17\_17** |
| **Contact Details for Modification Proposal Originator** |
| **Name** | **Telephone number** | **Email address** |
| **Nigel Thomson** |  |  |
| **Modification Proposal Title** |
| **Recovery of Costs due to Invalid Ex-Ante Contracted Quantities in Imbalance Settlement** |
| **Documents affected***(delete as appropriate)* | **Section(s) Affected** | **Version number of T&SC or AP used in Drafting** |
| **T&SC Part B**  | **Section G** | **Version 20** |
| **Explanation of Proposed Change***(mandatory by originator)* |
| ***It is recommended to read the “Modification Proposal Justification” section of this proposal to provide the context for its submission prior to reading this section and subsequent sections of the proposed changes.***The changes proposed to the TSC seek to provide a workable solution to how specific low probability risks related to imbalances due to invalid Ex-Ante Market Contracted Quantities are mitigated in the I-SEM, given the interrelationship between the Ex-Ante Markets and Imbalance Settlement.The modification consists of changes to Section G of Part B of the Code to:1. Provide SEM NEMO’s time to recover costs from the relevant Exchange Member in order to pay Imbalance settlement due to invalid Contracted Quantities.
2. Clauses to withhold TSC payments to the relevant SEMO Participant subject to an invalid Contracted Quantity where the withholding of TSC payments will minimise the costs needing recovery for the invalid Contracted Quantity.
3. Utilise the short payment functions under the TSC until such time as costs have been recovered by the SEM NEMO.
4. Hold the SEM NEMO harmless for credit cover requirements related to the invalid Contracted Quantity related imbalance.
 |
| **Legal Drafting Change***(Clearly show proposed code change using* ***tracked*** *changes, if proposer fails to identify changes, please indicate best estimate of potential changes)* |
| The following provides a summary of the text changes needed to the TSC to accommodate the modification. Once the general principles are agreed, a detailed drafting of the legal text changes will be undertaken. The majority of changes are expected to be made to Section G of Part B of the Trading and Settlement Code. Although as part of the formal legal drafting further consideration to the placement of the changes will be made. The identified changes are:1. Where a Contracted Quantity is considered invalid and there is insufficient time to obtain this cost recovery by the SEM NEMO prior to payment due dates for Imbalance Settlement, the SEM NEMO will notify the Balancing Market Operator of the situation, providing details of the issue, the units involved, the Contracted Quantities involved, their validity periods, steps being taken to recover the costs and an estimation of the time to recover the costs.
2. The MO will:
	1. If the Participant the Unit(s) relate to is expecting a payment under the TSC settlement, the MO shall short pay the Participant for the value of the Contracted Quantities multiplied by the relevant imbalance price [the **‘imbalance amount’**] and the SEM NEMO shall short pay the MO for the same Settlement Document for the imbalance amount (thereby for the TSC settlement reducing the value of the imbalance payments being paid out to match the imbalance payments being received). The Participants and SEM NEMO’s credit cover requirement will be amended to exclude the short pay amounts as these will have effectively been negated.
	2. If under a) the Participant does not have sufficient payments owing them to cover the full imbalance amount then the MO shall use the short payment functionality under section G.2.7.3 of the Code to short pay all relevant Participants until such time as the imbalance amount is recovered.

Under both scenarios a) and b) above, where the SEM NEMO has provided the correct notification to the MO of the situation, the SEM NEMO will not be considered under G 2.7.2 to be in default for any amount that it short pays related to the situation, nor have the imbalance considered in credit cover calculations. [Although they would still have an obligation to seek to recover the imbalance amount]1. Where the SEM NEMO subsequently recovers the costs then these will be paid to the MO and subsequently distributed to all Participants who have been short paid.
 |
| **Modification Proposal Justification***(Clearly state the reason for the Modification)* |
| **Why is the Modification being raised?**The design of the I-SEM includes a component related to Imbalance Settlement being based partly on Contracted Quantities agreed in Ex-Ante Markets. The consequences of any such Contracted Quantity being considered invalid by the Market Operator is an imbalance occurring against the relevant SEM NEMO under the Trading and Settlement Code - for the value of the Contracted Quantity at the Imbalance Price.During SEMOpx’s evaluation of financial risks associated the interrelationship between the Ex-Ante Markets and Imbalance Settlement there have been identified specific “scenarios” that could lead to this situation of Contracted Quantities being considered invalid in Imbalance Settlement. Although they have an extremely low probability of occurrence the impact in terms of financial costs needing recovery could be high.SEMOpx does not have the financial resources nor operating environment to cover this type of potential risk neither in the short term through working capital to finance the imbalance costs for imbalance settlement while the invalid Contracted Quantity costs are recovered, nor in the long term should the invalid Contract Quantity costs not be recovered. Therefore, mechanisms must be in place to mitigate against these risk scenarios and their impacts to ensure SEMOpx is not exposed to liabilities imposed by the Balancing Market that it is not able to take on.**How the Risk Eventuates**The specific scenarios identified, with an indication of their probability and impact, are provided below.

|  |  |  |
| --- | --- | --- |
| Scenario | Probability | Impact |
| Exchange Member trades in the Ex-Ante Markets before a Unit is effective in the Balancing Market | Extremely Low | High |
| Exchange Member trades in the Ex-Ante Markets while a Trading Halt should have been in effect. | Very Low | High |
| Exchange Member trades in the Ex-Ante Markets while a Suspension of the relevant Unit from the Balancing Market is in effect. | Extremely Low | High |

**Probability of the Risk Occurring**To illustrate the extremely low probability of this event occurring, the diagram below shows the sequence of events that would need to occur in order for this risk to eventuate.**Impact if the Risk Eventuates**While the probability of the scenario occurring is extremely low the impact of such an event could be significant. Although it is difficult to quantify the monetary impact of the scenarios – as there is a great deal of variability and lack of historical data in most cases. However, examples of the costs that could need recovery are illustrated below.Please note that:* These exposures are only expected for one auction and trading day as measures would be implemented immediately to rectify the issue and avoid further invalid Contracted Quantities for subsequent auctions.
* The figures assume that the Ex-Ante payments for the invalid Contracted Quantity has not been able to be withheld - which would reduce the costs needing recovery to just the Contract Quantity x the difference in Imbalance and Ex-Ante prices.[[1]](#footnote-1)

**Implications for Imbalance Settlement**To recover the costs associated with any of the invalid Contracted Quantity scenario, a SEM NEMO would need to obtain the relevant costs in order to pay the imbalance. The processes to recover these costs are very unlikely to be able to be completed in sufficient time to meet the required payment deadlines for Imbalance Settlement.In additional, although a SEM NEMO will utilise several mechanisms in order to recover the invalid Contracted Quantity costs, there is still an extremely low probability that the costs are never fully recovered and therefore the imbalance cannot be fully repaid by SEM NEMO in Imbalance Settlement.This provides two key issues of:1. Who funds the working capital of the imbalance under Imbalance Settlement until the costs of the invalid Contracted Quantity are recovered?
2. Who ultimately, if all other measures fail, bares the cost of any remaining costs related to the invalid Contracted Quantity?

**Who funds the Working Capital to cover the Imbalance prior to Recovery?**Based on the financial and operating model proposed for SEMOpx under regulatory requirements, the service will operate on a cost pass through model with no allowance for the costs of working capital. Therefore, SEMOpx is not in a position to provide working capital to fund an imbalance due to invalid Contracted Quantities.Therefore the only plausible solution is that a SEM NEMO can notify the Market Operator of a delay in recovering the costs associated with the invalid Contracted Quantity and the Market Operator in acknowledging this delay, hold SEM NEMO harmless and short pay the relevant recipients of the imbalance payment until such time as the costs can be recovered by SEM NEMO. **If all else fails, who bares any residual costs of the invalid Contracted Quantity?**In considering the baring of residual costs, it should be noted that prior to this ultimate baring of invalid Contract Quantity costs there will be a number of mitigation measures that will be looked at to be implemented in order to minimise the likelihood of this bad debt occurring. These mitigation measures mean that in additional to the event being extremely unlikely to occur, the chances of the costs not being recovered, using the mitigation measures below, are extremely low.**Mitigation Measures to Minimise Residual Costs**The potential measures to mitigate the baring of invalid Contracted Quantities could include:1. SEM NEMO withholding payment to the Exchange Member for the value of the invalid Contracted Quantities therefore minimising the costs needing recovery.
2. SEMO to withhold any payments for the relevant Units in Imbalance Settlement to minimise the costs needing recovery.
3. SEM NEMO to charge the Exchange Member that caused the invalid Contracted Quantities through trading in the Ex-Ante Markets, when not authorised to do so.
4. SEM NEMO to use contributions to a default fund where the costs cannot be recovered from the Exchange Member.
5. SEM NEMO to charge all other Exchange Members where the costs cannot be recovered from the Exchange Member or the Default Fund.
6. Where the issue can be attributed to SEM NEMO’s service providers, recovery of costs through liability provisions.

Thus, in order for the bad debt to ultimately crystalize, all the mitigation measures would have to have failed. As outlined in the diagram below.Note that not all these mitigation measures have been confirmed as implementable at this point in time, but all are being looked at as a suite of mitigation measures to minimise the likelihood of the bad debt situation eventuating.**Other Mitigation Measures that were Dispelled**There were also other measures considered to mitigate the impacts of these invalid Contracted Quantity scenarios. However, these have not been included as they are seen as inappropriate due to one or more of the following: they result in additional and considerable upfront and continuing costs for Exchange Members to cover a risk that has extremely low probability, the solution may cause major issues with the ongoing viability of the Ex-Ante Markets, or they are not feasible for implementation in the timeframes before I-SEM go-live. The measures that were considered, but dispelled were:1. Imposing significant additional collateral requirements on all Exchange Members to cover this risk scenario
2. Taking out insurance against these scenarios
3. Increasing Exchange fees upfront to cover this potential risk
4. Increasing Exchange fees after the event occurs to cover the realised residual costs.

**Proposed Approach for Residual Costs**Based on the financial and operating model proposed for SEMOpx under regulatory requirements, SEMOpx is not in a position to ultimately backstop the invalid Contracted Quantity costs should they not be recovered by other mitigation measures.Therefore the only plausible solution is that a SEM NEMO could notify the Balancing Market Operator that the costs of invalid Contracted Quantity cannot be fully recovered and any unrecovered costs must be maintained as a bad debt by SEMO Participants. |
| **Code Objectives Furthered***(State the Code Objectives the Proposal furthers, see Section A of T&SC for Code Objectives)* |
| This Modification proposal aims to further the Code Objectives under TSC Section A.2.1.4, specifically the elements shown in bold below.(b) to **facilitate the efficient, economic and coordinated operation**, administrationand development of the Single Electricity Market **in a financially secure****manner;****(c)** to **facilitate the participation of electricity undertakings engaged in the generation, supply or sale of electricity** in the trading arrangements under the Single Electricity Market;(e) to **provide transparency in the operation** of the Single Electricity Market;(g) to **promote the short-term and long-term interests of consumers of electricity on the island of Ireland with respect to price**, quality, reliability, and security of supply of electricity.  |
| **Implication of not implementing the Modification Proposal***(State the possible outcomes should the Modification Proposal not be implemented)* |
| The implications of not implementing this modification proposal is that liability clauses related to the SEMOpx Rules will not be able to agreed and Exchange Members will not be willing, without these clauses known, to sign the Exchange Member Agreement to facilitate trading in the I-SEM Ex-Ante Markets. |
| **Working Group***(State if Working Group considered necessary to develop proposal)* | **Impacts***(Indicate the impacts on systems, resources, processes and/or procedures; also indicate impacts on any other Market Code such as Capacity Marker Code, Grid Code, Exchange Rules etc.)* |
| Given: the limited time available, in order to provide clarity and certainty to Exchange Members and Participants about the recovery of costs related to invalid Contracted Quantities, it is proposed that the focus be on using this proposal as a basis for the final modification with any amendments being made to the proposal rather considering a number of alternatives from scratch which may take considerably more time, effort and may jeopardize the readiness of the market for I-SEM go-live. | The outcome of this modification proposal will have implications on SEM NEMO Rules. |
| ***Please return this form to Secretariat by email to*** ***modifications@sem-o.com*** |

**Notes on completing Modification Proposal Form:**

1. **If a person submits a Modification Proposal on behalf of another person, that person who proposes the material of the change should be identified on the Modification Proposal Form as the Modification Proposal Originator.**
2. **Any person raising a Modification Proposal shall ensure that their proposal is clear and substantiated with the appropriate detail including the way in which it furthers the Code Objectives to enable it to be fully considered by the Modifications Committee.**
3. **Each Modification Proposal will include a draft text of the proposed Modification to the Code unless, if raising a Provisional Modification Proposal whereby legal drafting text is not imperative.**
4. **For the purposes of this Modification Proposal Form, the following terms shall have the following meanings:**

**Agreed Procedure(s): means the detailed procedures to be followed by Parties in performing their obligations and functions under the Code as listed in either Part A or Part B Appendix D “List of Agreed Procedures”. The Proposer will need to specify whether the Agreed Procedure to modify refers to Part A, Part B or both.**

**T&SC / Code: means the Trading and Settlement Code for the Single Electricity Market. The Proposer will also need to specify whether all Part A, Part B, Part C of the Code or a subset of these, are affected by the proposed Modification;**

**Modification Proposal: means the proposal to modify the Code as set out in the attached form**

**Derivative Work: means any text or work which incorporates or contains all or part of the Modification Proposal or any adaptation, abridgement, expansion or other modification of the Modification Proposal**

**The terms “Market Operator”, “Modifications Committee” and “Regulatory Authorities” shall have the meanings assigned to those terms in the Code.**

**In consideration for the right to submit, and have the Modification Proposal assessed in accordance with the terms of Section 2 of Part A or Chapter B of Part B of the Code (and Part A Agreed Procedure 12 or Part B Agreed Procedure 12) , which I have read and understand, I agree as follows:**

**1. I hereby grant a worldwide, perpetual, royalty-free, non-exclusive licence:**

* 1. **to the Market Operator and the Regulatory Authorities to publish and/or distribute the Modification Proposal for free and unrestricted access;**
	2. **to the Regulatory Authorities, the Modifications Committee and each member of the Modifications Committee to amend, adapt, combine, abridge, expand or otherwise modify the Modification Proposal at their sole discretion for the purpose of developing the Modification Proposal in accordance with the Code;**
	3. **to the Market Operator and the Regulatory Authorities to incorporate the Modification Proposal into the Code;**

**1.4 to all Parties to the Code and the Regulatory Authorities to use, reproduce and distribute the Modification Proposal, whether as part of the Code or otherwise, for any purpose arising out of or in connection with the Code.**

**2. The licences set out in clause 1 shall equally apply to any Derivative Works.**

**3. I hereby waive in favour of the Parties to the Code and the Regulatory Authorities any and all moral rights I may have arising out of or in connection with the Modification Proposal or any Derivative Works.**

**4. I hereby warrant that, except where expressly indicated otherwise, I am the owner of the copyright and any other intellectual property and proprietary rights in the Modification Proposal and, where not the owner, I have the requisite permissions to grant the rights set out in this form.**

**5. I hereby acknowledge that the Modification Proposal may be rejected by the Modifications Committee and/or the Regulatory Authorities and that there is no guarantee that my Modification Proposal will be incorporated into the Code.**

1. To be confirmed whether the withholding of Ex-Ante payments is possible given payment cycles. [↑](#footnote-ref-1)